



# 2014-15 Research Programme



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### Introduction

In bringing together the various elements of Bruegel's planned work for 2014-2015 it is evident that the various hangovers from the crises in Europe are still affecting economic performance and policy. And we are also aware that another economic crisis with new financial stress can re-emerge and that the best way to prevent this is to get policies right – both the structural and the macroeconomic ones. Reflecting this post-crisis phase, Bruegel's planned work emphasises economic growth and performance, but also the broader governance and institutional questions. For example, while there may be intellectual consensus on banking union, we are only at the beginning of a discussion on a capital markets union. Appropriate fiscal governance and structural reform are often cited, but the devil is in the details and the debate on appropriate implementation is in full swing. Part of our work will therefore focus on monitoring and making suggestions on how to improve the implementation of what has in principle been agreed on. But we will also continue to reflect and make proposals on the deeper and still unresolved institutional questions, including the question of a fiscal capacity.

As in previous years, we have designed a programme with the aim of maintaining current valuable work streams whilst adding appropriate new elements. We have, hopefully, struck the right balance between planned work and the ability to respond to policy developments that will inevitably affect us all over the research year. Bruegel's ability to respond quickly to these developments has helped us build our reputation and it will be an important part of our output during the next research year.

Specific to this new programme, increased work on Europe's neighbourhood has been added as recent events have once again reminded Europe and Europeans that we exist in a global community. We have published on Ukraine and plan to continue with this work. In the 25 years since the fall of the Berlin wall Europe has completely changed. We plan to reflect on these changes and their effect on the people and economies of central and Eastern Europe. As regards the global economy, the appointment of a non-Resident Fellow with expertise on China will contribute to Bruegel's work on analysing Asia's policies and their impact on Europe.

Perhaps the best cure for Europe's post-crisis hangover is a stronger focus on how developments in competition, innovation and entrepreneurship can contribute to growth in Europe. Over recent years we have strengthened the breadth of this work, and this will be continued in the coming research year. Besides entrepreneurship, the digital economy and the contribution of universities to growth, we will work on drivers of secular stagnation, the role of the single market and on the positive role competition policy can play. Energy union is another topic of central importance for our continent.

We received much wise help from Bruegel's members in making these decisions and together we have built another strong research agenda. We have also been mindful of the discussions we have had within the team, with members, the Board and other stakeholders on where we would like Bruegel's work to be in three years' time. I hope you can agree with me that the new Research Programme reflects Bruegel's values, builds on its strengths and will be a valuable contribution to improving Economic policy in Europe.

*Guntram Wolff, September 2014*

## **A. Research Area: European macroeconomics and governance**

Participants:

- *Resident scholars: Grégory Claeys, Zsolt Darvas, Silvia Merler, André Sapir, Nicolas Véron, Guntram Wolff*
- *Non-resident and visiting scholars: Alan Ahearne, Mark Hallerberg, Yukihiro Matsuyama, Ashoka Mody, Rainer Münz, Shahin Vallée*

The acute pressure on euro-area financial markets has eased considerably and there are several benign developments in Europe, such as a gradual economic recovery, progress with structural reforms and fiscal adjustment, the correction of pre-crisis current account deficits and eased financial fragmentation. However, there are major underlying problems throughout the EU, which pose threats to economic and financial stability. Production is still well below potential while unemployment is unacceptably high in a number of EU states; major fiscal adjustment lies ahead in several countries as well as the design and implementation of structural reforms; high public, private and external debts prefigure protracted deleveraging, constraining the growth of highly indebted sectors and countries; inflation throughout the EU, and in particular in the euro area, is on a downward trend; and it is far from certain that bank lending will be restored, while the development of non-bank financing is slow.

At the same time, major institutional reforms in the EU have led to a complicated and incomplete economic governance framework, whose effectiveness is still to be tested. Mistrust between countries and between citizens and the EU will make it more difficult to revise the current institutional framework and design new instruments. The banking union deserves more analysis and discussion. The economic performance of non-euro-area countries and the implications of the new euro area institutional framework to them is a major issue that we will also consider.

As in previous years, Bruegel would like to keep a fair degree of flexibility in order to be able to react to new developments and policy responses. But as a baseline, we plan to continue our research themes followed in the past years, focusing on addressing medium- and longer-term issues too, such as macroeconomic policy and adjustment and the emerging European economic governance. We also wish to work on the EU budget and the achievements and challenges in central and Eastern Europe 25 years after the fall of the Berlin Wall.

There are also a number of projects which cover other research areas beyond European macroeconomics and are introduced in the next sections of this research programme. We will continue a project from the 2013/14 research programme on growth and secular stagnation, which is at the intersection of research areas A and D and is detailed under research area D. Bruegel will prepare two papers for the ASEM finance ministers meeting in Milan (September 2014), focusing on lessons from European economic and financial integration for Asia. We will continue working on the design and implementation of banking union, including the governance relation between the euro area and the non-euro area countries, the project is detailed under research area C. A new project on the assessment of the macro-prudential frameworks in Europe is also detailed under research area C.

### **1. Macroeconomic policies and adjustments in EMU**

This research theme has been at the core of our European macroeconomic research during the past few years, and will continue with a renewed focus in 2014/15. While progress with budget and current account deficits was made, high public, private and external debts pose serious threats in a number of EU countries. Too-low inflation throughout the EU, and in particular in the euro area, is making debt sustainability and intra-euro competitiveness adjustment more difficult.

- We will analyse the causes and consequences of too-low inflation, as well as monetary and other policy measures to combat too-low inflation. Their effectiveness will be a major issue to analyse.
- We will prepare a progress report on price- and wage-competitiveness adjustments, as well as adjustment of employment. Similarly, an overview of the progress of structural reforms is timely.
- We will also assess in detail capital flows and stocks in the EU with a global perspective and set up a unique database on bilateral financial flows and stocks. We will also work on migration flows in the EU and their connection to adjustment.
- Last but not least, we will continue our work on the fiscal policy stance, fiscal adjustment, the composition of fiscal adjustment and the impact on growth, social effects and well-being of the sometimes substantial cuts in youth and family spending, health spending and the like.

## **2. Governance of the euro area and the EU**

It remains to be seen how the new EU leadership, and governments of those countries where EU-sceptic political parties have received significant popular support, will pursue new institutional reforms. While Bruegel has made a number of proposals on how to improve economic institutions as well as having assessed some elements of the new economic governance framework, the main emphasis in 2014/15 will be on assessing the new framework on the one hand, while further driving the debate on how the EU's governance system could be improved both within the remits of the current treaty as well as with potential treaty changes, on the other. In particular, we plan a detailed assessment of the new fiscal framework. The 6-Pack and 2-Pack include a review clause according to which the legislation will have to be reviewed for the first time at the end of 2014 and amended if necessary. This offers a major opportunity to assess the conceptual underpinnings, procedural complexity and implementation to date. We will also assess the macroeconomic imbalances procedure, by focusing on the adequacy of suggestions and success in implementing the suggestions. Moreover, we will reflect on how the current fiscal framework, the ESM and the EU budget can be further developed and how and when a system of own resources can be established. Questions of legitimacy, transparency and political accountability will also feature prominently. A further central topic for research is how a further deepening of the euro area will affect relations with non-euro area countries and in particular the UK. Research related to the banking union, capital markets union and macro-prudential policies are introduced in research area C but obviously there are numerous connections.

## **3. EU budget review**

The multiannual EU budget before the start of a new multiannual financial framework is always the result of a complicated negotiation procedure, which has historically kept the structure of the budget rather similar to the preceding one. However, there are major concerns with the appropriateness of the budget, and in particular, with the two largest spending items, the structural and cohesion funds and the common agricultural policy. This research aims to assess, using an extensive literature survey and our own analysis, the appropriateness of expenditure categories and will propose reforms for the 2016 review of the EU budget, as well as longer term reforms. It will also be linked to the more institutional discussion on how and whether the EU budget should eventually be transformed to give it a fiscal capacity.

## **4. 25 years after the fall of the Berlin wall**

On the occasion of the 25<sup>th</sup> anniversary of the fall of the wall, we will review three dimensions of transition in central and Eastern Europe: (1) institutions, to assess how democratic and market institutions have developed in these countries and how has EU membership helped institutional development; (2) economics, to analyse the drivers of catching-up and various inequalities that

emerged with the transition, and (3) people, to evaluate the change in the quality of life and opportunities for people in central and eastern European (CEE) countries. The research will focus on EU countries, as well as the former East Germany, and other CEE countries with an EU perspective, in comparison with other countries of the world with similar levels of development.

#### **5. Financial assistance to banks and the role of different EU institutions**

Many countries in the EU have provided state aid and other forms of financial assistance in the last years to banks. EU institutions play an important role in supervising this assistance, setting common standards and also coordinating the approach. Work for this study has already started as it was part of the 2013-14 research programme and will be carried over to the next research year.

## **B. Research Area: Global economics and global governance**

Participants:

- *Resident scholars: Zsolt Darvas, André Sapir, Nicolas Véron, Karen Wilson, Guntram Wolff*
- *Non-resident and visiting scholars: Alan Ahearne, Suparna Karmakar, Guonan Ma, Ashoka Mody, Jim O'Neil, Shahin Vallée*

The interactions between Europe and the international economy are manifold. The crisis of the euro area has been an opportunity for the world to discover the importance of interdependence in the same way the financial crisis of 2007-2008 highlighted the magnitude of spill overs from the US to the rest of the world. This interdependence is a structural feature of the world economy that needs to be analysed as such, rather than simply in its short-term manifestations. The main structural feature of the world economy in its current historical phase is the shifting of economic dynamics from the Atlantic to the Pacific Ocean and from the developed to the emerging economies.

In 2014/15, Bruegel will continue to devote a fair share of its resources to analysing developments in the world economy, with special attention to the interactions between, on the one side, European (or European-based) actors and, on the other side, global actors and actors located in the EU's neighbourhood. The three main lines of research will be Asia, global governance and relations between the EU and major regional players.

### **1. Asia initiatives**

From its very beginning, Bruegel has been keen on developing contacts in Asia and collaborating with economists from various parts of Asia. Together with European and Asian partners, Bruegel established in 2006 the Asia Europe Economic Forum (AEEF) to serve as a high level forum, giving Asian and European policy experts an occasion for in-depth research-based exchanges on global issues of mutual interest. This important forum will continue its activities in 2014/15. After the last successful conference in Berlin, the next conference is scheduled to take place in Tokyo.

Bruegel has advanced its leadership in this area and intends to become a globally recognised hub for Asia-Europe economic discussions and exchanges. Bruegel has recently hosted and will continue to host visiting scholars from China and Japan. Bruegel has co-organised a conference in Beijing and in Seoul in the fall of 2013 and in Beijing in the late spring of 2014. Similar conferences are planned for 2014/15. Bruegel has managed to attract an eminent scholar and expert on the Chinese economy to join its team of non-resident scholars. The scholar is very committed and the intention is to gradually build a research profile on China.

Moreover, a conference comparing Japan and the EU on macro and structural features will be held in October 2014 at Bruegel together with Kobe University.

### **2. Global economy and governance**

In spite of the apparent weakness of the global trading system, WTO rules resisted the recent economic and financial crisis with relatively little increase in protectionism. Yet, trade protectionist calls have become more vocal recently, in particular in relation to China. Moreover, more bilateral trade agreements have been struck and numerous new negotiations have started. Bruegel will continue work on the global trading system and on the current TTIP negotiations mostly in the form of events and blogs.

Bruegel is also working on G7/G20 governance issues and will contribute to the topic with comments and other contributions. We plan a comparative study on deleveraging in the financial and non-financial corporate sector, household and government sectors in several major areas around the world.

Lessons will be drawn from economic and financial integration in Europe for Asia. A further important topic concerns monetary policy across the World and this is covered in research area A.

### **3. Major regional players**

Bruegel has devoted increasing resources to the EU neighbourhood and has had, with limited resources, a significant impact on the economic debate on Ukraine. At the moment, Bruegel lacks resources to be able to contribute significantly to research on the EU neighbourhood but we have attracted a non-resident scholar to work on Ukraine and Russia. There is little doubt that this is an important, perhaps even vital, issue for the EU both economically (linked to energy and migration issues) and politically (linked to the potential volatility of the region). As a result, Bruegel has decided to invest some effort in keeping abreast of developments in the non-EU Mediterranean region, covering not only the Southern Mediterranean Countries but also other Mediterranean countries, in particular Turkey. We will again organise a workshop on Turkey and non-EU Mediterranean countries with a Turkish think-tank. Fund raising activities in this area will be stepped up.

### **C. Research Area: Finance and financial regulation**

#### *Participants:*

- *Resident scholars: Zsolt Darvas, Silvia Merler, André Sapir, Nicolas Véron, Karen Wilson, Guntram Wolff*
- *Nonresident and visiting scholars: Michiel Bijlsma, Elliot Posner*

The proposals made here are in the continuity of Bruegel's research. In parallel to the research endeavours described below, the successful Finance Focus Breakfast series of about-monthly events at Bruegel will be continued and help shed light on specific challenges for EU financial policy.

#### **1. The European Banking Union and capital markets union**

The European banking union agenda is expected to be a continuously visible item on the European reform agenda. Building on substantive contributions to this debate since 2007, upcoming policy challenges will be analysed and recommendations formulated. The focus will shift increasingly to implementation and application of the existing banking union. A special focus will be on bank restructuring and resolution in the wake of the stress tests. The timeliness of contributions will continue to be central.

Bruegel has been advocating for the further development of the financial system to create additional financial intermediation channels that could reduce the credit gap and contribute to risk-absorption channels (for example Sapir and Wolff, "The neglected side of banking union", Bruegel policy contribution to informal ECOFIN September 2013). In this project, we will drive the debate on a "capital markets union" which has received new impetus with the speech by Commission president Juncker.

#### **2. The transformation of the financial system**

The financial crisis since 2007 has redefined the terms of the policy debate on European financial integration, with contradictory trends of accelerated EU integration of financial policy, on the one hand, and partial renationalisation of credit conditions, on the other hand.

At an analytical level, Bruegel will continue work on mapping the European financial landscape and identifying evidence of recent trends affecting it; and providing insight on the underlying factors, including political and institutional drivers. The work will focus on different aspects of the financial system in a comparative manner. This includes studying transnational financial firms and global financial centres, systemic risk in the insurance industry, as well as capital flows in the EU and their implications for macro- and micro-prudential policy. A further important topic will be the way SMEs and early-stage innovative firms can be financed.

#### **3. Corporate financial transparency in a global economy**

Building on more than a decade of recognised research in this area, Bruegel wishes to clarify developments in financial reporting policy and practices with a view to explaining the wider implications for financial stability and developments. Bruegel scholars have been appointed to an independent expert group on IAS regulation advising the European Commission's DG Markt. The work will result in a number of blog entries.

## **D. Research Area: Competition, Innovation and Sustainable Growth**

Participants:

- *Resident scholars: Reinhilde Veugelers, Georg Zachmann, Mario Mariniello, Zsolt Darvas, Karen Wilson*
- *Non-resident and visiting scholars: Carlo Altomonte*
- *External contributors: SIMPATIC project team*

Bruegel's work in this research area is guided by one leitmotif: how to improve economic growth and competitiveness. The weak growth performance in Europe – both before and during the crisis – calls for a re-think of Europe's growth strategy and more rigorous implementation and monitoring of available tools. This requires analysing, on the one hand, the macro-economic obstacles to growth and on the other hand the microeconomic and structural impediments to competitiveness in all of their various dimensions. The increase in resources in this research area has strengthened the work on market structure and competition policy as well as on network effects. Also, more work on entrepreneurship and conditions for business entry has been started. More specifically, the team's multiple skills allow addressing various dimensions of the structural impediments to economic performance: innovation policy, competition policy, entrepreneurialism, energy policy.

### **1. Long term economic growth, secular stagnation and Europe's competitiveness map**

With the crisis, the level of potential output has shifted downward in many advanced countries and in most of them the potential growth rate is also reduced. Bruegel will contribute to the topic of long term drivers of growth and secular stagnation. A further research project, MAPCOMPETE, funded by FP7 resources, will produce a European competitiveness map. A further project will investigate the determinants and obstacles to long term investment as a critical factor for network industries with large financing needs in particular. We will also study the drivers of sectorial competitive advantages.

### **2. Entrepreneurial ecosystems, the role of R&D policies, patents and the digital economy**

A further important research strand is on entrepreneurship and innovation. The different projects look into the reasons for Europe's weak innovation performance, into the missing funding for innovation and young firms and into the regulatory and administrative barriers holding back entrepreneurship in Europe. One larger project, called SIMPATIC, is funded by the European Commission and develops a comprehensive and operational tool box allowing for a better assessment of the impact of research and innovation policies in Europe. Finally, we plan to publish a paper on the unitary patent.

### **3. Education and the role of universities for innovation and growth**

As Europe begins to show signs of a recovery, the lack of jobs remains a central issue. Youth unemployment remains high and there is therefore a need to explore skill gaps and the role the education system can play in reducing youth unemployment. More generally, the role of the education system in the debate on Europe's structural reforms has probably been underestimated. The way universities contribute to growth and innovation is explored in a further project.

### **4. Energy union**

In this project, Bruegel wants to analyse the degree to which a Europeanization of energy policy would make economic sense. Building on many years of recognised research in the area, this topic has become particularly relevant in the context of the Ukrainian crisis.

### **5. Competition policy, European network industries and national fragmentation**

A third research focus is on competition policy, market structure and growth. A number of projects are planned. One project continues the work of this year on comparing competition policy across the EU and China. In the current project, it is planned to assess cross-border takeovers of firms and offer a cross-jurisdictional comparison with particular attention to the EU, US and Chinese frameworks. A

second project will explore to what extent and how to include “out of market” efficiencies in network industries in merger and antitrust control. A third project will explore ex-post assessments of merger and antitrust remedies. We will also work on an assessment of the single market and the different channels through which integration can benefit Europe’s economy. Finally, in view of completing the single market, a last project will explore differences in national competition policies.